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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 1091

NATIONAL MANUFACTURE AND STORES CORPORATION, PETITIONER

v.

MARION H. ALLEN, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The District Court of the United States for the Middle District of Georgia wrote no opinion; its findings of fact and conclusions of law appear in the record at pages 27–31. The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 38–44) is reported at 125 F. (2d) 239.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 28, 1942 (R. 44). The peti-

tion for a writ of certiorari was filed March 31, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Where a corporation buys on margin shares of its own stock in 1930 and 1931 and sells them in 1937, is the resulting gain taxable as gross income to the corporation under Section 22 (a) of the Revenue Act of 1936 and Article 22 (a)–16 of Treasury Regulations 94?

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Revenue Act of 1936 and Treasury Regulations 94 are set forth in the Appendix, *infra,* pp. 9–10.

STATEMENT

The facts are not in dispute and may be stated as follows:

Petitioner, a Delaware corporation, reported its income for the year ending June 30, 1937, and paid the tax thereon amounting to $8,747.96. Thereafter, on October 2, 1939, it filed a claim for refund on the ground that it had erroneously included in its reported income the sum of $24,875.65, which represented the net amount it had received for the sale in March 1937 of 6,900 shares of its own treasury stock in excess of the amount it had paid for the stock. The claim for

refund not having been acted upon by the Commissioner of Internal Revenue within six months, petitioner instituted the present suit to recover from the respondent Collector (R. 27–28). Recovery was granted by the District Court (R. 31–32). The judgment was reversed by the Circuit Court of Appeals, one judge dissenting (R. 44).

The 6,900 shares of stock sold by petitioner had been bought by it on the open market in 1930 and 1931 pursuant to a policy of reducing its outstanding common stock by purchasing it for retirement at such times as the price was considered advantageous. Petitioner had purchased the shares here involved through Hayden-Stone Company, a brokerage house. The total purchase price was $43,842.50, including commissions, but because at the time petitioner could not reduce its cash working capital, it did not pay Hayden-Stone the full amount. Hayden-Stone agreed to carry the indebtedness until the company was able to pay it. Meanwhile Hayden-Stone retained possession of the stock. For this reason, the stock, unlike other shares bought by petitioner, was never cancelled and retired on the books of the company, but was carried as treasury stock (R. 28–29).

Between 1931 and 1937 the financial condition of the company became worse and in the latter year petitioner decided to sell common stock in

order to obtain working funds. On March 15, 1937, it sold all the shares here involved to a syndicate of brokers for the net amount of $68,718.15. The sale price was below the fair value and market price of the stock, but $24,875.65 in excess of the net purchase price (R. 28–30).

ARGUMENT

The decision of the court below that petitioner realized gain "as if it had purchased the stock of any other corporation on margin on a low market and sold it later at a profit on a higher market" (R. 42) is in accord with applicable Treasury regulations which had been promulgated prior to the tax year involved. The decision is correct and not in conflict with any other decision. Although the question is one which may well be litigated in other cases in the lower courts, there would appear to be no basis for certiorari here.

Article 22 (a)–16 of Treasury Regulations 94 (Appendix, *infra*, p. 10) promulgated under the Revenue Act of 1936 provides that—

> * * * if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. * * *

The same provision was contained in Article 22 (a)–16 of Treasury Regulations 86, promulgated under the Revenue Act of 1934, and is contained

in the regulations promulgated under the Revenue Act of 1938 (Article 22 (a)–16 of Treasury Regulations 101) and under the Internal Revenue Code (Section 19.22 (a)–16 of Treasury Regulations 103).

Substantially similar language was contained in Treasury Decision 4430, XIII–1 Cum. Bull. 36, which was adopted May 2, 1934, shortly before the enactment of the Revenue Act of 1934. This decision amended prior regulations which, since 1920, had provided that a corporation's purchase of its own stock was a capital transaction from which the corporation could realize neither gain nor loss.[1] The new interpretation was in accord with the regulations which had been in force under the Revenue Act of 1916 as amended in 1917 (Article 98 of Treasury Regulations 33 (revised 1918)), and with the opinions in *Commissioner* v. *S. A. Woods Mach. Co.,* 57 F. (2d) 635 (C. C. A. 1), certiorari denied, 287 U. S. 613, and other cases.[2]

In *Helvering* v. *Reynolds Co.,* 306 U. S. 110, this Court held that, in view of the repeated

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[1] Treasury Regulations 45 (Revenue Act of 1918), Articles 542 and 563; Treasury Regulations 62 (Revenue Act of 1921), 65 (Revenue Act of 1924), and 69 (Revenue Act of 1926), Articles 543 and 563; Treasury Regulations 74 (Revenue Act of 1928) and 77 (Revenue Act of 1932), Articles 66 and 176.

[2] *Walville Lumber Co.* v. *Commissioner*, 35 F. (2d) 445 (C. C. A. 9); *Spear & Co.* v. *Heiner*, 54 F. (2d) 134 (W. D. Pa.), affirmed, 61 F. (2d) 1030 (C. C. A. 3); *Commissioner* v. *Boca Ceiga Development Co.*, 66 F. (2d) 1004 (C. C. A. 3).

reenactment since 1920 of the statutory definition of gross income contained in Section 22 (a), the Treasury decision could not be applied retroactively to a transaction occurring in 1929. In so doing, however, the Court agreed with the Government that Section 22 (a) is "so general in its terms as to render an interpretative regulation appropriate" (p. 114). Moreover, while the Court did not decide the question whether the new interpretation could be applied prospectively, it stated that "It may be that by the passage of the Revenue Act of 1936 the Treasury was authorized thereafter to apply the regulation in its amended form" (p. 117).

Thus, there seems little basis for petitioner's contention (Pet. 4, 13–14) that the successive reenactments of Section 22 (a) without change during the period from 1920 to 1934 so far adopted the then existing regulations as to preclude the Treasury from later altering them for prospective application.[3] See *Helvering* v. *Wilshire Oil Co.*,

[3] The dissenting judge in the instant case agreed that Article 22 (a)–16 is a valid regulation, but thought it inapplicable for the reason that petitioner had not dealt in its stock within the intendment of the words "deals" and "dealing" appearing in the regulation (R. 40–41). However, where as here a corporation sells its treasury stock as it would its other property, the regulation and statute apply whether or not the corporation had bought in its stock for speculative purposes or was engaged in a course of other such dealings. Cf. G. C. M. 12955, XIII–1, Cum. Bull. 107 (1934); G. C. M. 16651, XV–2 Cum. Bull. 130 (1936); and authorities cited *infra*, footnote 5.

308 U. S. 90; *Helvering* v. *Reynolds,* 313 U. S. 428. The expression of a contrary view in *E. R. Squibb & Sons* v. *Helvering,* 98 F. (2d) 69, 70, modified, 102 F. (2d) 681 (C. C. A. 2), which involved an attempted retrospective application of the changed regulations, is inconsistent with the subsequent decisions of this Court just cited. See also *Morrissey* v. *Commissioner,* 296 U. S. 344, 355.

Petitioners assert (Pet. 3–4, 9) that the instant decision conflicts with the decision in the *Squibb* case in that the Circuit Court of Appeals for the Second Circuit there held that a corporation does not derive taxable income from the sale of its own treasury stock if the sale price, although higher than the purchase price paid by the corporation, is less than the value of the stock at the time of the sale. The opinion in the *Squibb* case contains *dicta* to that effect (98 F. (2d) 70–71), but the point cannot be considered as having been decided since there was no evidence as to the value of the stock and since the Government's contention that the new regulation could be applied retroactively to the sale in question was overruled solely on the ground that "only legislation could dislodge" the interpretation embodied in the displaced regulation.[4] See 102 F. (2d) 681, 682. In any event,

[4] The decision of the court below in *Johnson* v. *Commissioner*, 56 F. (2d) 58, cited by petitioners as being in conflict with the instant decision involved, and was based on, the old regulations.

the decision of the court below accords with the view of other courts and authorities.[5]

CONCLUSION

It is respectfully submitted that for the reasons stated the petition should be denied.

Respectfully submitted.

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APRIL 1942.

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[5] *First Chrold Corp.* v. *Commissioner*, 97 F. (2d) 22 (C. C. A. 3), reversed on another ground, 306 U. S. 117; *Investment Corp. of Phila.* v. *United States* (E. D. Pa.), decided December 17, 1941 (not officially reported but found in 1942 C. C. H., Vol. 4, par. 9206). Comment, *Taxability of Transactions by A Corporation On Its Own Stock* (1937), 47 Yale L. J. 111. See also *R. J. Reynolds Tobacco Co.* v. *Commissioner*, 97 F. (2d) 302, 306–308 (C. C. A. 4), affirmed, 306 U. S. 110.